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April 2, 2013

The Honorable Vern Buchanan
U.S. House of Representatives
2104 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Allyson Schwartz
U.S. House of Representatives
1227 Longworth House Office Building
Washington, D.C. 20515

Dear Reps. Buchanan and Schwartz:

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue-neutral, repeal the Alternative Minimum Tax (AMT), and be fair to farmers and ranchers.

We commend the Ways and Means Committee on its methodical approach to tax reform by forming working groups to review current law and to compile feedback from stakeholders, academics, think tanks, practitioners, the general public and elected representatives. We offer the following comments on tax issues important to farmers and ranchers to you, as the chair and co-chair of the Small Business/Pass Throughs working group.

INCOME TAXES

Comprehensive Reform is Essential

Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate tax reform. The most common form of farm ownership is sole-proprietor which accounts for 86.5 percent of all farms and 50 percent of sales. Partnerships comprise 7.9 percent of farm operations and 20 percent of sales. Incorporated farms, both C-corps and S-corps, comprise 4.4 percent of farms but account for 30 percent of sales with the vast majority of these farm corporations being family-held. In total, more than 96 percent of farms and 75 percent of farm sales are taxed under the provisions of the Internal Revenue Code (IRC) provisions affecting individual taxpayers. (USDA 2007 Census of Agriculture).

Because many business deductions and credits are used by both corporate and pass-through businesses, their elimination in exchange for corporate-only rate reduction will result in a tax increase for the vast majority of farmers and ranchers who pay taxes as individuals. One example is the domestic production expense deduction, which amounts to an average $8,926 deduction per eligible farm household. (USDA Economic Information Bulletin Number 107, February 2013). Thus, any tax reform proposal that fails to reform the individual tax code will not help, and more likely hurt, the bulk of agricultural producers.

The loss of business tax deductions could also disadvantage family farm businesses that operate as C-corps because they tend to be small and already pay taxes on the lower side of the corporate rate scale. Just as with non-incorporated farms and ranches, they would be hurt by the loss of deductions but would not benefit completely from reduced corporate tax rates. In particular, the 15 percent bracket for corporations with taxable income up to $50,000 should be retained and expanded, so that the income level is indexed for inflation using 1986 as a base.

Lowering Rates Alone, While Important, May Not Benefit Farm and Ranch Businesses

While broadening the base and lowering the tax rate is important to any tax reform effort and is supported by Farm Bureau, it must be noted that lowering rates will impact farm and ranches differently than other businesses. While farm and ranch expenses continue from year to year with some variation, this is not true for farm income. Whether caused by unpredictable weather that affects crop yields or uncontrollable markets that set the price of goods sold, it is not uncommon for farmers and ranchers to have years with little or no taxable income. USDA reports that, based on IRS data, nearly three of every four farm sole proprietors reported a farm loss in 2010 and that since 1980 farm sole proprietors as a group have reported negative aggregate net farm income for tax purposes. About half of farm partnerships and small business corporations also report losses. (USDA Economic Information Bulletin 107, February 2013.) Thus, a lower individual rate may not adequately compensate farmers for lost tax provisions and over time could result in a higher effective tax rate. Allowing an unused deduction or credit to be carried backwards can provide an immediate benefit while carrying forward provides a delayed benefit. To accommodate the tax anomaly, Farm Bureau recommends that farmers and ranchers be allowed to apply the tax benefits of excess deductions and credits to previous and/or future tax years.

Farmers Need Tools to Deal with the Uncertainties of Agriculture

Under a progressive tax rate system, farmers and ranchers, whose incomes can fluctuate widely from year to year, will pay more total taxes over a period of time than taxpayers with more stable incomes unless they are allowed to take advantage of tax tools to even out taxable income. Cash accounting combined with the ability to accelerate expenses and defer income gives farmers and ranchers the flexibility to manage their tax burden on an annual basis by allowing them to target an optimum level of taxable income. In addition, cash accounting allows farmers and ranchers to improve cash flow, reduce the need to incur debt, simplifies record keeping and gives an accurate reflection of a farmer or rancher’s financial situation since cash accounting records revenue and expenses when they occur.

Cash accounting tools important to farmers and ranchers include the deferral of commodity and product receipts and prepaying the cost of livestock feed, fertilizer, and other farm supplies. The option to prepay input costs gives farmers and ranchers the flexibility they need to plan, make major investments in their businesses and in many cases provides guaranteed availability of some agricultural inputs. This is especially important because farm productions expenses are rising with 2013 costs forecast to be 5.7 percent higher than 2012 and 42 percent higher than the 2002 through 2011 average. Farm Bureau supports the continuation of unrestricted cash accounting for farmers and ranchers who pay taxes as individuals and cautions against reducing the number of corporate farms eligible to use it.

Another important tool that farmers and ranchers use to reduce income swings and to manage tax liabilities is farm income averaging. In 2004, according to IRS tax data, 50,800 farmers reduced their tax liability on average by $4,434 with income averaging. (USDA Economic Information Bulletin Number 107, February 2013). This provision would be even more valuable to farmers and ranchers if the averaging period were extended. Farm Bureau recommends that farmers and ranchers be allowed to average income over a five year period instead of the current three year period and allowing farmers the flexibility to determine how much eligible farm income to assign to a specific prior year.

Expensing is Important to Capital-Intensive Businesses like Agriculture

Because farming requires large investments in machinery, equipment and other depreciable capital, farmers and ranchers place great value on tax code provisions that allow them to write off capital expenditures in the year that purchases are made. Tax provisions that accelerate expensing and depreciation allow farmers and ranchers to better manage cash flow, minimize tax liabilities and reduce borrowing. The ability to immediately expense capital purchases also offers the benefit of reducing the record keeping burden associated with the depreciation.

The share of farm assets attributable to machinery and farm-use motor vehicles currently makes up 5.6 percent of total assets owned by farmers and ranchers and the percentage is growing. According to 2010 USDA Agricultural Resource Management Survey (ARMS) data, capital investments averaged $32,000 for those making investments. But averages don't tell the whole story because in a year when a farm business makes a major purchase, for example, a combine for $350,000 or a tractor for $200,000, business expenditures will spike. Of special significance to farmers and ranchers is the ability to use Sec. 179 Small Business Expensing. Because farmers and ranchers make single large purchases, Farm Bureau supports maintaining the $500,000 Sec. 179 small business expensing limitation and not reducing the $2 million acquisition limit. Farm Bureau also supports allowing farmers and ranchers to use bonus depreciation; expense soil and water conservation expenditures; deduct the cost of raising dairy and breeding cattle; deduct fertilizer and soil conditioner costs; deduct the cost of raising timber; depreciate single purpose ag structures over shorter lives; and deduct reforestation expenses.

Capital Gains Taxes Continue to Plague Farmers and Ranchers

Capital gains taxes continue to be a problem for farmers and ranchers even though Congress enacted a permanent 15-percent tax rate for taxpayers making under $400,000 (single person)/$450,000 (couple). However, the tax rate that farmers and ranchers will pay will almost always be at the higher 20-percent rate because capital gains income will spike and can easily exceed income thresholds in the year that a farmer or rancher sells land. The higher rate will be imposed even though a farmer's or rancher's average annual income would not have exceeded the thresholds. For these reasons, Farm Bureau supports eliminating capital gains taxes and, until that can be accomplished, supports cutting the capital gains tax rate for all taxpayer and providing an exclusion for farmland that remains in agriculture or is sold to a family member who continues the family business. Farm Bureau also supports repealing the Medicare Contribution Tax. Farm Bureau's complete statement on capital gains taxes, filed with the Ways and Means Committee working group on debt, equity and capital, is attached to this letter.

Other Provisions that are Important to Farmers and Ranchers

The vast majority of farmers and ranchers are self-employed and as such are able to take a 100 percent deduction for the health insurance premiums they pay against their income taxes. According to the USDA Economic Information Bulletin Number 107, February 2013, the average deduction for farm families using the deduction amounts to $6,173. Farm Bureau supports continuation or this deduction and recommends that it be expanded so that a deduction can also be taken against self-employment taxes.

Farmers and ranchers pay a disproportional amount of their income in property taxes because the value of their business is land-based and thus more subject to the real property tax than other businesses and individuals. Because the size of a real property tax bill is based on the value of the land owned and not the amount of money earned on that land, it is not linked to the landowners' ability to pay. This can create special hardships for farmers with land but relatively low cash flow. For this reason Farm Bureau supports the continuation of the deduction for local and state property tax paid on business assets and income.

Statements Filed with Other Working Groups

Farm Bureau has also filed letters with the working group on Energy supporting tax incentives for renewal energy, the working group on Manufacturing about the domestic production expense deduction and the working group on Charitable/Exempt Organizations.

Section 263AUnicap Rules

Uniform capitalization rules are complex and a record keeping burden for those who grow plants for resale and who grow perennial crops. A grower must include certain direct and indirect costs in the basis of property and then recover these costs through depreciation or at the time of sale when there is a preproductive period of more than two years. Farm Bureau supports excluding businesses with less than $10 million of average annual gross receipts from the uniform capitalization rules as proposed by the Ways and Means Committee small business discussion draft.

Since the discussion draft proposes to eliminate Section 263A requirements for businesses with gross receipts less than $10 million, farmers and ranchers should be allowed to use the same depreciation methods as other taxpayers. In 1987, in a compromise allowing producers of livestock an exception from Unicap requirements, all farm producers were restricted from using the 200-percent declining balance method of depreciation. With the elimination of Section 263A for the vast majority of farmers, the policy reason for limiting farm depreciation methods is moot.

ESTATE TAXES

Estate Taxes Remain a Concern for Farmers and Ranchers

While some consider estate taxes outside the boundaries of fundamental tax reform, the issue continues to be one of the most worrisome tax issues facing farmers and ranchers. Individuals, family partnerships and family corporations own 98 percent of our nation’s more than 2 million farms and ranches. The value of family-owned farms and ranches is usually tied to illiquid assets, such as land, buildings and equipment. With 85 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax. When estate taxes exceed cash and other liquid assets, surviving family partners may be forced to sell land, buildings or equipment needed to keep their businesses running. This not only can cripple a farm or ranch operation, but also hurts the rural communities and businesses that agriculture supports.

Farm Bureau commends Congress for enacting permanent estate tax law that provides for a $5 million per person exemption indexed for inflation, the transfer to the spouse of any unused exemption amount and the continuation of the step-up in basis. However, with agriculture cropland values increasing on average 15 percent from 2011 to 2012, more and more farms are in danger of topping the exemption and estate tax planning continues to be complex and expensive for those close to or over the threshold. Farm Bureau continues to believe that estate taxes should be eliminated. Until permanent repeal is achieved, the exemption should be increased and indexed to inflation. We also support an increase in the gift tax exemption and indexing it for inflation.

Stepped-up Basis is Important to Farmers and Ranchers

Continuation of stepped-up basis at death is also very important to farmers and ranchers. Under stepped-up basis, a decedent’s beneficiaries inherit assets with a basis for computing depreciation and capital gains equal to the fair market value of the assets on the date of the decedent’s death. If the assets are sold by the heirs, capital gains taxes are only due on the increase in value since the property was inherited. One historical reason for the basis adjustment rules is the perceived unfairness of imposing a double tax on a beneficiary who inherits assets, first an estate tax, and then a capital gains tax when the executor or beneficiary subsequently sells the asset, especially if the sale was necessary to raise money to pay the estate tax. Additionally, there are practical concerns about calculating the basis for very long-held assets where the purchase price might be unknown and basis adjusting expenditures are difficult to substantiate. Farm Bureau supports the continuation of full unlimited step up in basis.

An Expanded Sec. 2032A Would Benefit Farmers and Ranchers

Special Use Valuation (Sec. 2032A) provides a valuable estate tax planning tool for farmers and ranchers who live in high land value areas. Sec. 2032A gives farmers, ranchers and other business owners the ability to reduce their estate taxes by allowing a limited amount of business property to be valued for its actual use rather than for its highest value use for estate tax purposes. For example, farmland could be valued at its farm value rather than what it would be worth if sold for development. Many farmers and ranchers are, however, reluctant to use Sec.

2032A because of its limited benefits, because there are significant penalties imposed when the terms of its use are violated and because of its complex nature.

More family farms and ranches could be protected from estate taxes if Section 2032A was expanded and certain transfers were allowed. Currently, the value of property may not be reduced by more than $1 million indexed for inflation. This means that if the value of a farm for development purposes was $8 million and the farm value was $5 million, the use value assigned to the property under 2032A for estate tax purposes would be $7 million. There is also a restriction that says that part or all of the tax savings from using 2032A must be paid back if, within ten years, there is a sale of a conservation easement or if timber is sold off the property. Farm Bureau supports removing the limitation on the amount that property value can be reduced for use value under sec. 2032A and supports eliminating the recapture tax for timbering or selling a conservation easement.

Farm Bureau thanks you for your consideration of our views on tax reform issues of importance to farm and ranch businesses. We would be glad to meet with you to provide additional information or to discuss our positions in greater detail.

Sincerely,

Bob Stallman
President